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Reserve Oil and Gas Company 1971 Annual Report

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Annual Meeting

The Annual Meeting of Shareholders will be held at 10:00 a.m. on April 17, 1972 in the Los Angeles Room of the Los Angeles Hilton Hotel. The regular notice and proxy statement will be mailed to Shareholders in advance of the meeting.

Reserve Oil and Gas Company

EXECUTIVE OFFICES:
550 South Flower St.
Los Angeles, California 90017

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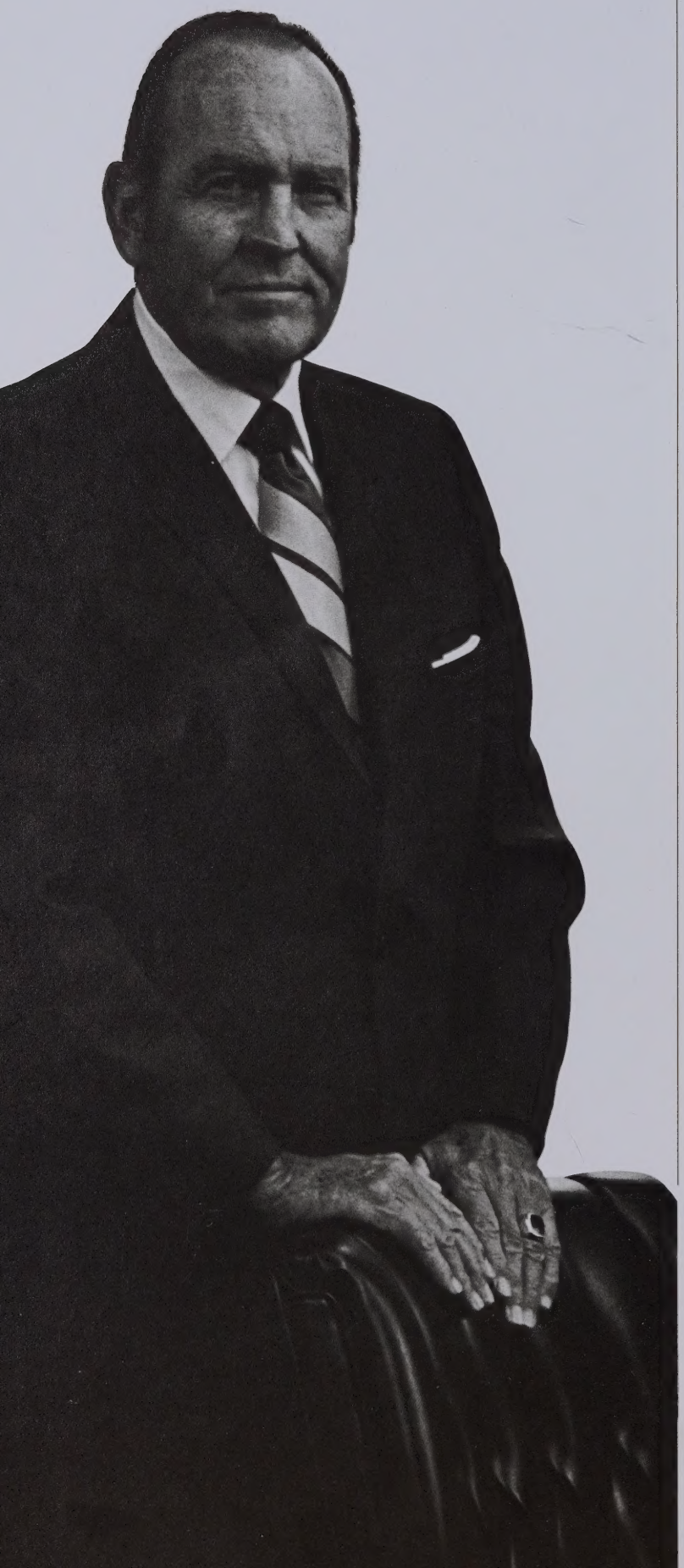
Financial and Operating Highlights

Financial	1971	1970
Total revenues from continuing operations	$48,540,891	$43,448,164
Income from continuing operations	3,673,761	3,609,194
Per common share	.35	.34
Loss from discontinued operations and extraordinary items	—	(6,093,287)
Per common share	—	(.65)
Net income (loss)	3,673,761	(2,484,093)
Per common share	.35	(.31)
Working capital	10,854,247	10,612,291
Shareholders' equity	60,996,104	55,017,990
Total assets	80,451,656	74,010,474
Operating		
Crude oil and natural gas liquids production, barrels per day	9,683	9,734
Natural gas sales, Mcf per day	34,122	35,363

Regenerator tower in Canadian Reserve's new South Lone Pine Creek gas processing plant



From the President

On March 16, 1972 Reserve began its fortieth year in business. Its thirty-ninth year—1971—was one in which solid progress was made in all of the Company's lines of business.

Consolidated net income totaled $3,673,761, amounting to 35¢ per common share on the 9,327,755 common shares outstanding during the year. This compares with a net loss in 1970 of $2,484,093, amounting to 31¢ per common share, resulting primarily from the discontinuance of fertilizer operations.

Gross revenues for the year were at a record high of $48,540,891, up 12% over the $43,448,164 recorded in the prior year. This gain resulted primarily from increases in crude oil prices in the United States and Canada and an all-time high in sales of gasoline by Mohawk.

Funds flow amounted to $6,863,962, compared with $5,938,354 in 1970. Major expenditures included $9,028,040 for additions to properties, $3,914,263 for debt retirement and $3,282,388 for applications of principal on the Company's Mid-Continent and Canadian production payment obligations. Notwithstanding these heavy expenditures working capital increased by $241,956 in 1971, and remained at a satisfactory $10,854,247 level at year-end.

The outstanding feature of the year in the oil industry was the extraordinary acceleration of the pace of oil and gas exploration activity in Canada.

In 1969 your Company acquired vast frontier acreage holdings in Canada. At that time there had been no oil and gas discoveries north of Norman Wells in the Northwest Territories and no hydrocarbons had been found in the Arctic area or the East Coast region.

Since that time, Imperial Oil Co. Ltd. has reported four significant oil, gas and condensate discoveries on the Mackenzie Delta in the Northwest Territories. Panarctic Oils Ltd. has found gas and condensate at Drake Point on Melville Island and has discovered gas on King Christian Island. Just recently, Panarctic has again scored with a gas discovery in its Kristoffer Bay G-06 well on Ellef Ringnes Island.

Late in 1971, on the East Coast of Canada, Mobil Oil Canada Ltd. electrified the industry with the announcement that they had discovered hydrocarbons in seventeen zones on their E-48 well on Sable Island off Nova Scotia. Four of these zones produced both crude oil and natural gas, twelve flowed both natural gas and condensate, and one flowed gas alone.

The findings by these important discoveries now indicate that Reserve's immense Canadian frontier holdings are definitely in basins capable of producing hydrocarbons. The discoveries in these three remote areas have provided tremendous impetus to further exploration. It is anticipated that

the industry will spend more than $300 million in the Arctic Islands alone between 1972 and 1976, primarily in actual drilling. In order to maintain its large land position in the Arctic Islands throughout this period of extensive exploration work, Canadian Reserve will pursue independent exploration programs to evaluate its more attractive lands, will participate in drilling where this seems feasible and will negotiate farmout ventures for exploration work by others. During the 26 months between December of 1971 and September of 1969, when Canadian Reserve acquired its extensive Canadian exploratory holdings, it has completed eight substantial transactions with other companies which cover and validate the work requirements on a considerable portion of those holdings. The three latest of these transactions are described in detail in the text of this report.

The foregoing joint venture transactions involve very little cash outlay by your Company. The greatest part of the funds involved will be provided by other companies, whose objective is to acquire interests in the Canadian Reserve holdings. In addition to these funds, however, Canadian Reserve has budgeted over $2.7 million for exploration projects on its widespread blocks of acreage.

Development drilling will also be stepped up in 1972 in the Province areas. Follow-up drilling programs have or will be undertaken in those areas where hydrocarbon discoveries or field extensions were made in 1971, including the Sextet Region of Northeast British Columbia, the Medicine Hat area of Southern Alberta and the Manito-Kerrobert heavy crude area of Saskatchewan.

Favorable drilling and pipeline operating results in the Manito-Kerrobert area led your Company to acquire an additional 7½% interest in the Lone Rock-Kerrobert pipeline system, increasing its ownership to 47½%.

On December 7, 1971, the new Lone Pine Creek Gas Plant, in which Canadian Reserve owns a one-third interest, went on stream and is processing gas at rates which fully meet the plant operating forecasts. The plant operation is expected to contribute about $500,000 to Canadian Reserve's cash flow in 1972.

In November a new gas distillate field in Calcasieu Parish, Louisiana was discovered under the Halbouty-Reserve U.S. Exploration Program. Well Halbouty-Reserve No. 1 Walker flowed at the rate of 2.7 million cubic feet of gas and 32 barrels of 52° gravity condensate per day through a 15/64" choke. The new production was found in a 75-foot thick upper Frio sand encountered at 10,876 feet with pay indicated in the upper 32 feet. In December the U.S. Exploration Program was extended for an additional year with a further participant commitment of an additional $2 million in exploratory funds.

Property sales by the Apple Valley Ranchos Division, including lands owned by the Company and others, equaled $2.2 million. The decline from the equivalent $3.1 million figure for the prior year was attributed principally to generally unfavorable economic conditions. Modernization and renovation of the main dining areas and a number of the guest rooms at the Apple Valley Inn was completed in 1971 and additional improvements of this kind are planned for 1972. The Cedar Springs Dam was completed early in 1971 and Feather River project water is now creating Silverwood Lake, a new recreational area located less than 20 miles south of Apple Valley.

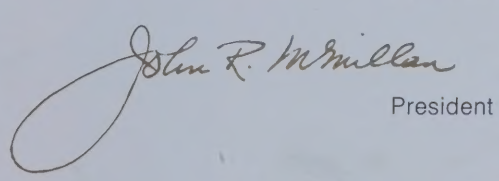
Mohawk Petroleum, the Company's refining and marketing subsidiary, had an outstanding year. Gasoline sales totaled 103,039,867 gallons for the year or more than 8,500,000 gallons per month, which is the highest in Mohawk's history. Many new retail sales outlets were established during the year and these totaled 241 at year-end, up from 191 in 1970. Mohawk obtained a new import license for 1972 totaling 2,858,826 barrels, up from an equivalent 2,537,480 barrels for 1971.

In September 1963 the Company acquired extensive properties in the Mid-Continent area, subject to existing production payments and additional production payments imposed at that time. These combined production payments totaled $22.3 million. In June of 1971 all of these production payments had been paid off except for the last segment totaling $4 million. This segment is projected to be paid off in December of this year. Following the retirement of this obligation, the Company's net cash flow projection for 1973 and subsequent years shows a very substantial increase.

In May of 1971 Canadian Reserve used a portion of the proceeds derived from its 1 million share stock offering to the Canadian public to retire its production payment obligations in the amount of $1.5 million.

At the end of 1971 Reserve had 20,165 common stock shareholders of record, the highest number in its history. Everyone associated with the Company is appreciative of this indication of widening interest in its activities. It also provides a strong incentive to them for continued dedicated efforts toward future growth and profit achievement for the Company.

For the Board of Directors



President

March 17, 1972

Exploration, Development and Operations

Canadian Reserve Oil and Gas Ltd.

Land: At year-end 1971, the Company held interests in 43.1 million gross acres and 26.4 million net undeveloped acres and overriding royalty interests on 5.1 million acres in British Columbia, Alberta, Saskatchewan and Manitoba, the Yukon and Northwest Territories, the Arctic Islands and off the east coast of Canada. In addition, productive land holdings of the Company in the western provinces of Canada amounted to 266,400 gross acres and 75,900 net acres.

During 1971 the Company, together with a joint owner, was granted a one-third interest in 19.5 million gross permit acres or 6.5 million net acres off the east coast of Canada, resulting in a major increase in the Company's land holdings for the year. The Company also expanded its land holdings in northeastern British Columbia through farmouts from other companies and by provincial government land purchases. Three significant farmout agreements, involving substantial land holdings of the Company, were concluded prior to year-end.

In the Eagle Plains area of the Yukon Territory, Canadian Delhi Oil Ltd. and its co-owners have agreed to complete a $700,000 exploration program by June 1, 1973 on 880,000 acres of Canadian Reserve permit holdings. Upon the completion of this expenditure, they will earn an undivided 30 percent interest in the farmout lands. Canadian Delhi has the option to earn a further 30 percent interest by completing an additional $700,000 of exploration work on the lands on or before June 1, 1975. In addition to the exploration commitment, Canadian Reserve also received a cash consideration.

In the Northwest Territories, an agreement was concluded with Canadian Ashland Exploration Ltd. on 664,000 permit acres owned by the Company in the Colville Lake area. Ashland et al have the right to earn a 50 percent interest in the lands by completing exploration commitments in the order of $1,400,000 on or before June 1, 1976. The agreement has two phases with Ashland et al. earning a 25 percent interest prior to June 1, 1974 and a further 25 percent interest on or before June 1, 1976.

Canadian Reserve Oil and Gas Ltd.
scale in miles
100 50 0 100 200 300
100% Working Interest
Partial Working Interest
Royalty Interest and Carried Interest
Sedimentary Basins
GREENLAND
BAFFIN BAY
BAFFIN ISLAND
HUDSON BAY
LABRADOR
NEWFOUNDLAND
GRAND BANKS
QUEBEC
GULF OF ST. LAWRENCE
P.E.I.
NEW BRUNSWICK
NOVA SCOTIA
HALIFAX
MOBIL SABLE ISLAND OIL AND GAS DISCOVERY
SABLE ISLAND
ONTARIO
QUEBEC
MONTREAL
OTTAWA
TORONTO
ATLANTIC OCEAN

Paul D. Meadows, President, Canadian Reserve

The total exploration funds to be expended in these two farmouts, if all commitments are fulfilled, will amount to $2,800,000.

In December 1971, Canadian Reserve concluded a farmout on 1,150,000 acres in the Cape Isachsen area in the Arctic Islands. These holdings are largely located in the inter-island ice area lying between 79 degrees and 80 degrees latitude and 99 degrees and 109 degrees longitude. Dome Petroleum Limited, the farmee, has agreed to comply with certain financial obligations and may elect to drill a well on or in the vicinity of the Canadian Reserve lands prior to August 1, 1975. In accordance with the terms of the farmout agreement, Dome is entitled to earn an undivided 50 percent interest in the Company's lands.

Production: Net production of oil and natural gas liquids during 1971 averaged 5,777 barrels per day, a 5.5 percent increase over the 1970 net production of 5,474 barrels per day. Net sales of gas in 1971 increased 15.6 percent to 14,604 MCF/D over the 1970 net sales of 12,637 MCF/D.

Net sulphur production during 1971 amounted to 119 long tons per day, down five long tons per day from the 1970 figure of 124 long tons per day. Depressed sulphur prices continued during 1971 as the Company sold 27,965 long tons of sulphur for a net-back price of $5.71 (Canadian) per long ton.

Drilling: During 1971 the Company participated in drilling 93 wells. Exploratory completions totalled 35 gross wells, 3 of which were carried interest wells drilled at no cost to the Company, and 4 were farmout wells where the drilling costs were borne by farmees in exchange for an interest in the lands on which the wells were drilled. Included in the total were 4 gross exploratory wells in British Columbia, 16 in Alberta, 11 in Saskatchewan and 4 in the Northwest Territories.

The Company's interest in the gross exploratory completions were equivalent to 15.4 net wells, of which 5.0 resulted in discoveries or field extensions. In addition to the exploratory wells, the Company participated in the drilling of 14 gross (7.0 net) stratigraphic tests in the heavy crude area of Saskatchewan.

Of the 58 gross development wells the Company participated in during 1971, 5 were drilled in British Columbia, 2 in Alberta and 51 in Saskatchewan. The Company's net interest in these wells was equivalent to 13.2 net wells, of which 10.9 net wells resulted in oil well completions.

Exploration and Development: During 1971, Canadian Reserve continued an active exploration policy and engaged in a variety of exploration projects in British Columbia, Alberta, Saskatchewan, the Yukon and Northwest Territories, the Arctic Islands and offshore eastern Canada. Particular emphasis was placed on exploration for substantial gas reserves in the Middle Devonian reefs of Northeastern British Columbia and exploring and developing additional heavy crude oil reserves in the Lone Rock-Kerrobert area of Saskatchewan.

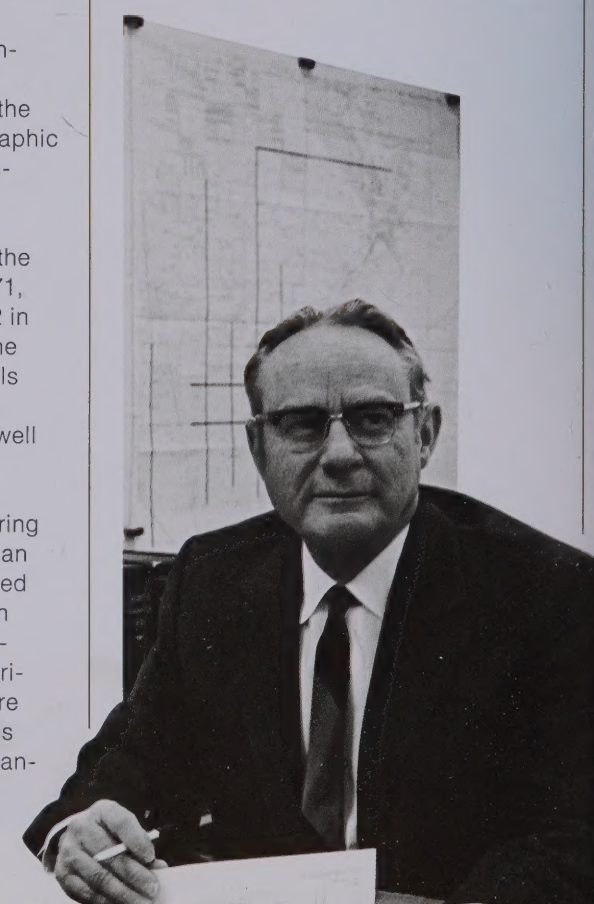
A summary of some of the more significant exploration and development activities undertaken or planned by the Company follows:

Northeast British Columbia: Canadian Reserve owns 722,034 gross (218,890 net) acres in Northeast British Columbia in addition to 38,611 net developed acres.

Over the past two years, the Company has increased its exploration endeavors in this area, through subsurface geologic studies and a review of all available seismic data so as to develop exploratory prospects in search of large potential gas reserves in Middle Devonian reefs. (See map on page 7.)

At year end, 1 well was drilling, 2 wells were in the process of completion and 6 wells were announced for drilling on lands in Northeast British Columbia in which the Company owns interests ranging from 11 percent to 50 percent.

Four of these wells were on carried interest lands and 4 were under farmout arrangements with other companies which will be drilled at no cost to Cana-



Harold F. Green, Vice President and Secretary

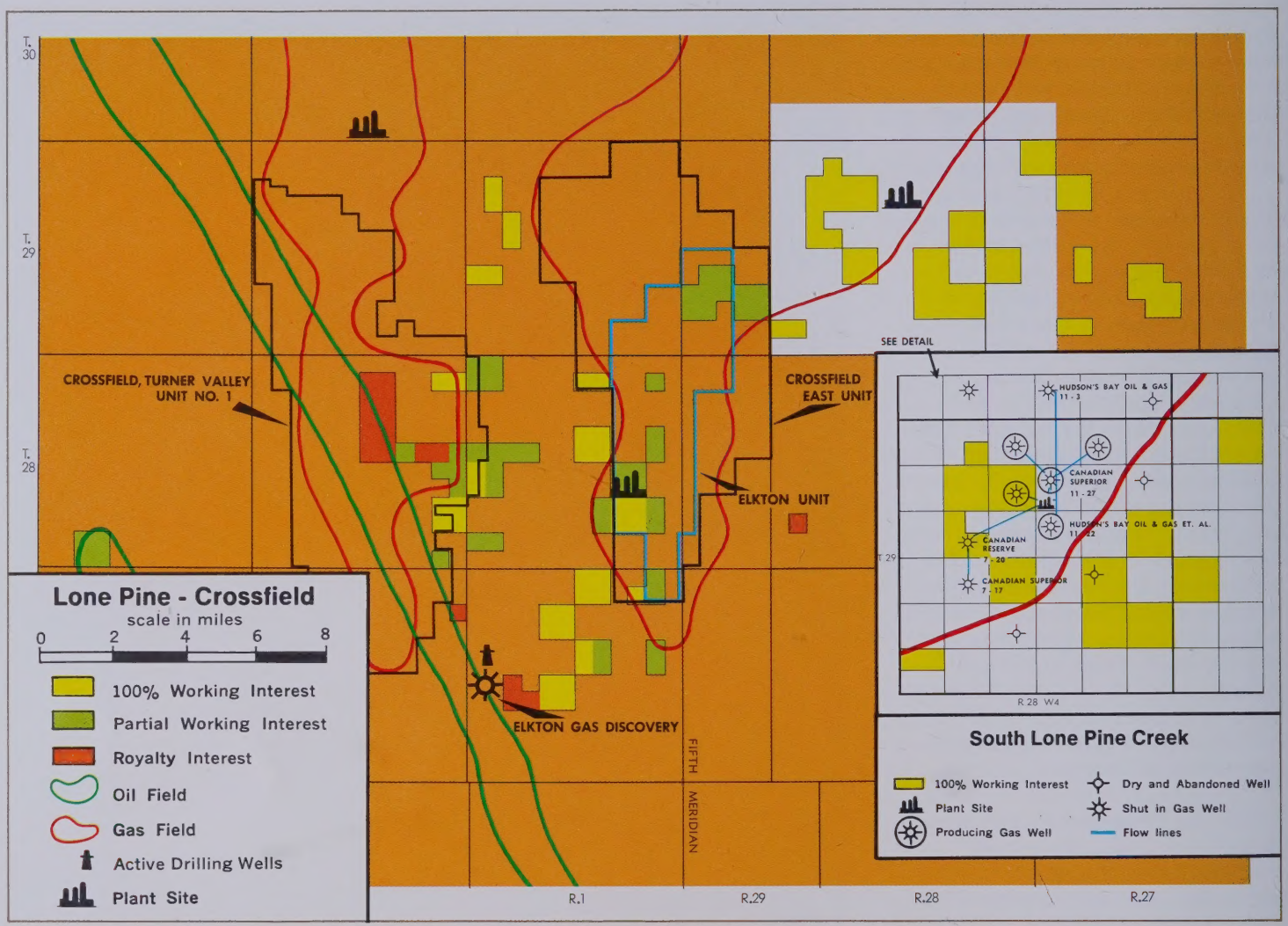
dian Reserve. In addition, some 20 exploratory wells were drilling or announced for drilling by other operators in the Middle Devonian reef trend of Northeast British Columbia directly related to the evaluation of the Company's acreage holdings in this area.

One of the wells in process of completion at year-end was a gas discovery in the Debolt Formation of Mississippian Age at a depth of 6360 feet. The well, Shenandoah et al., Jeans, d-75-A, in which the Company owns a 10.83 percent interest, is located 12 miles northeast of the Inga Field. It was drilled at no cost to the Company under the terms of a farmout agreement and was completed in January 1972 with a sustained flow rate of 2.5 million cubic feet per day. Canadian Reserve participated for a 10.83 percent interest with other owners in jointly acquiring at a recent land sale 1998 acres adjacent to the block of land on which the discovery well is located. Canadian Reserve's holdings in the vicinity of the discovery well now include a 10.83 percent interest in 11,850 acres and a 21.67 percent interest in 11,565 acres.

In 1971, the Company concluded a joint venture exploration program with another company to evaluate six specific Middle Devonian reef prospects. Total expenditures of $1.6 million for the six-prospect program are anticipated over the next two years, which will be paid 60 percent by the other company and 40 percent by Canadian Reserve, with interests in land and production to be owned 50 percent by each company.

One exploratory well, Canadian Reserve Adsett a-36-G, was drilling at year-end under the joint venture program and seismic operations were in progress which could result in the drilling of 2 other prospects during the current winter drilling season. The remaining 3 prospects are in various stages of exploration and are not expected to be evaluated for drilling prior to the winter of 1972-1973.

In the Sextet area, the Company and its 50 percent joint venturer were conducting a detailed seismic program at year-end on jointly owned lands to select an offset drillsite to a new gas discovery made in early 1971. The discovery well, Pacific Sextet c-22-K, in which Canadian Reserve has a 50 percent carried interest, was tested at flow rates up to 4 million cubic feet per day from the Slave Point formation. Canadian Reserve's land holdings in the vicinity of the discovery well include a 50 percent carried interest in 9,809 acres and a 50 percent working interest in 2,040 acres. The Company and its co-owner expect to drill the first follow-up well after completion of the seismic program on the 50 percent working interest lands.



Alberta: The Company owns a 100 percent interest in 6,551 undeveloped acres immediately east of the East Crossfield Unit located some 30 miles northeast of Calgary, Alberta. (See map above.) An additional 2,560 wholly owned acres in this area are included within the productive limits of the South Lone Pine Creek D-1 Sour Gas Field.

Immediately south of the East Crossfield unit, the Company owns a 100 percent interest in 2,407 acres, and a 50 percent interest in 642 acres. (Also shown on map above.) This area has increased potential as a result of 2 recent Elkton gas discoveries in Sections 18 and 19, Township 27, Range 1 W5M. Detailed seismic programs are planned by the Company in early 1972 to determine the limits of the potentially gas productive Elkton Formation underlying the Company's land holdings in the immediate area of the 2 discoveries.

Saskatchewan: The Company owns 46,176 gross and 36,098 net acres of oil and gas rights in the heavy crude oil producing area of Lloydminster and Lone Rock, Saskatchewan, of which 21,819 gross and 17,618 net acres have been developed by 689 gross wells, including unit wells, representing 262 net wells to the Company. (See map on page 9.) In addition, the Company owns 256,400 gross and 115,800 net acres located to the south of the Lone Rock area. These lands are along and in proximity to the Lone Rock-Kerrobert pipeline system which provides access to market for any new oil discoveries on such lands.

During 1971, Canadian Reserve continued to place emphasis on exploration for additional reserves and development of its properties in the heavy crude oil area of Saskatchewan in order to meet improved demand for asphalt-base

Directors not shown elsewhere in this report:
Left to Right—Howard C. Pyle, Joseph A. Ball, B. J. Westlund, Llewellyn Bixby, Jr., Marco F. Hellman

heavy crude oil. The Company during the year participated in the drilling of 11 exploratory wells, 45 development wells and 14 stratigraphic tests on its land holdings in this area. As a result of the 1971 drilling program, 42 (10.2 net) development wells were completed as producers, 6 exploratory wells resulted in heavy crude oil discoveries and the presence of 3 potentially productive oil bearing sands were discovered by the stratigraphic tests.

The most significant exploratory test well encountered 52 feet of heavy crude oil-bearing sand in the Dina Formation at a depth of 2,470 feet, in the Drake Lake area. The discovery well, 1-16-40-28 W3, in which the Company owns a 50 percent interest, was completed in July 1971 and was produced at rates in excess of 150 barrels of 14.1° gravity crude oil per day.

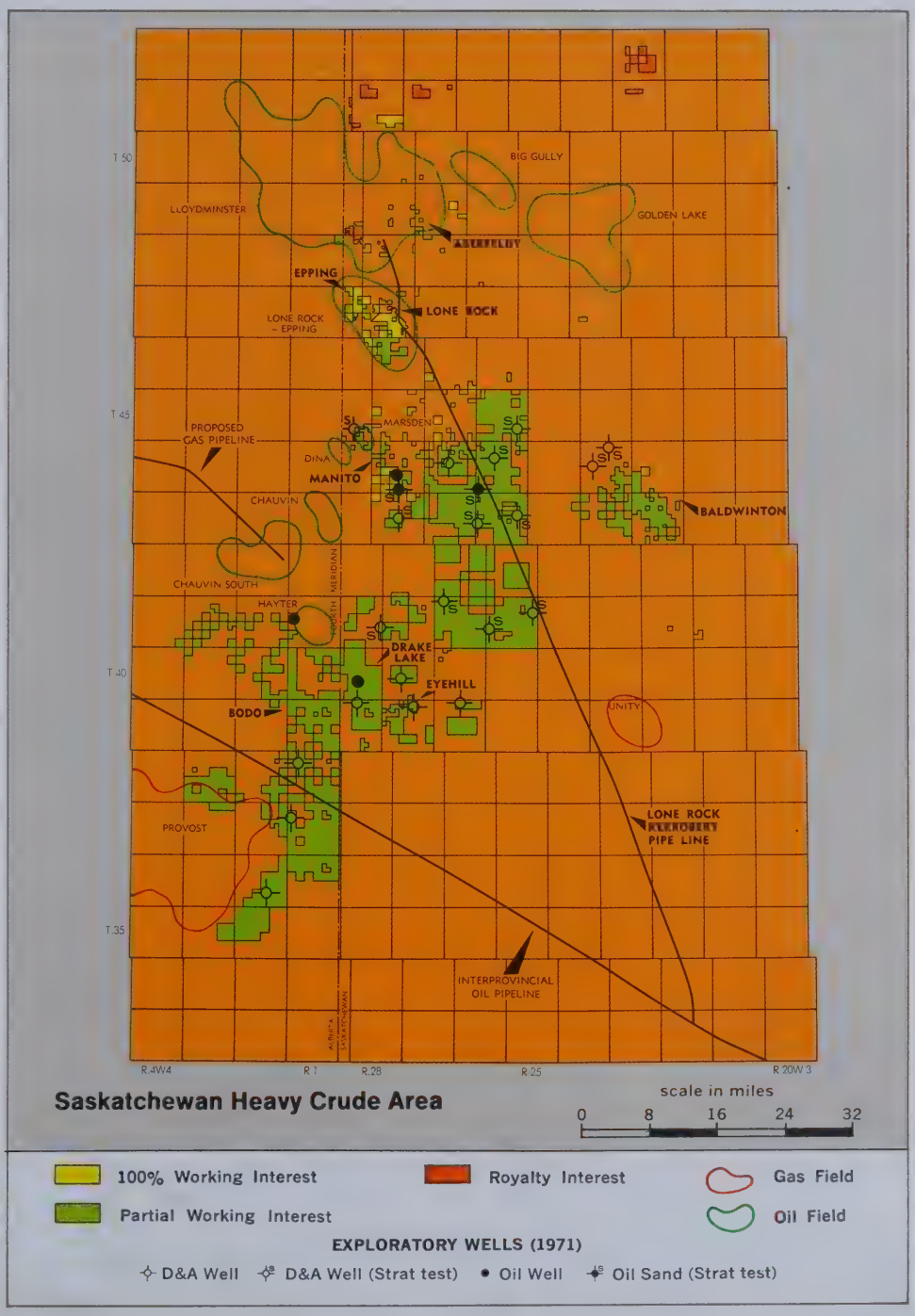
Subsequent to completion of the exploratory well, 3 additional offset development wells and 2 step-out exploratory wells were drilled prior to year-end. 3 of the development wells and 1 step-out well were completed for production with the remaining step-out well awaiting completion at year-end. The 2 exploratory step-out wells were drilled to evaluate lands posted for sale which resulted in the acquisition by the Company and a 50 percent associate, in December 1971, of 2 drilling reservations totaling 9,600 acres and 2 leases totaling 564 acres. As a result of these acquisitions, the Company and its associate control 15,924 acres of oil and gas rights in this area. Additional development and exploratory drilling will be conducted during the first half of 1972 to determine the areal extent and to evaluate the sustained producibility of the Dina Sand.

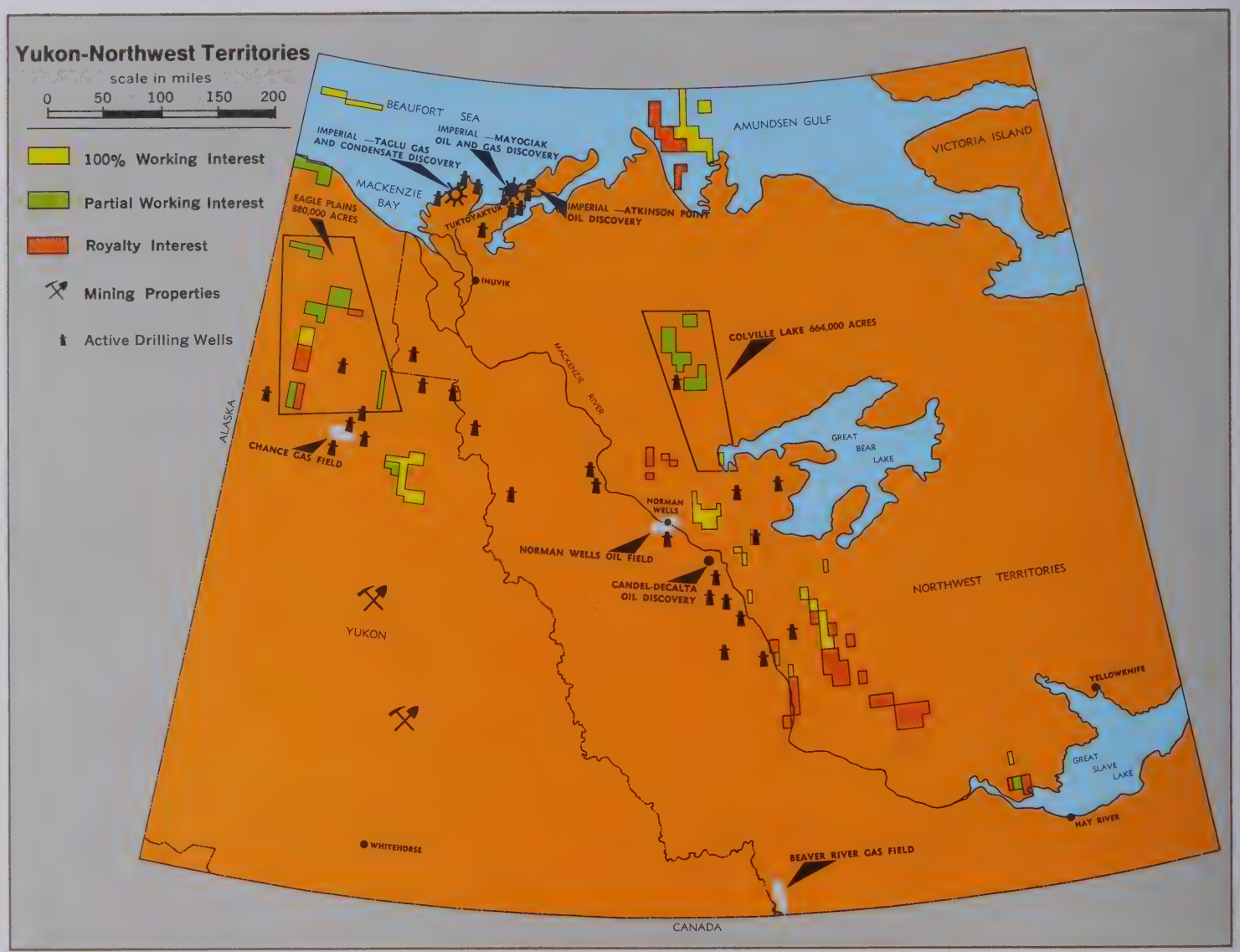
As a result of the 1971 heavy crude oil exploration program, Canadian Reserve plans to participate in the drilling of some 25 development wells in 1972. In addition, the Company in association with other companies, plans a minimum exploratory drilling program for the year of 20 exploratory wells and 5 stratigraphic tests.

Yukon and Northwest Territories: The Company holds 4 million gross acres and 3 million net acres of exploratory oil and gas rights in the Yukon and Northwest Territories. In addition, overriding royalty interests are held on 2.8 million acres.

Peter Bosche, Manager of Lands

William H. LeRoy, Manager of Exploration





The acreage representation of Canadian Reserve and the drilling activity in the Yukon and Northwest Territories is shown on the map above. At year-end 1971 some 30 exploratory wells had been announced for drilling or were in the process of drilling by all operators throughout the total region, thus making it the most active frontier exploration area in Canada.

The Company during the summer season 1971 completed surface geologic exploration on 5 blocks of its permit land holdings totaling 139,865 gross acres located to the north and east of Norman Wells in the Northwest Territories. The surface geologic work was successful in delineating 3 surface structural closures which warrant extensive geophysical surveys now planned by the Company for the 1972-1973 winter season. Early in 1971 Canadian Reserve, in joint ownership with another 50 percent owner, completed a 3 well drilling program to evaluate Middle Devonian Reef prospects in the southern plains of the Northwest Territories. The venture was unsuccessful and certain permits were dropped leaving the joint venture with 310,158 gross acres out of an original 2.4 million acre position.

Arctic Islands: The Company holds 11,400,000 gross acres (10,064,000 net acres) of exploratory oil and gas rights in the Arctic Islands of Northern Canada. In addition, overriding royalties are held on 1,400,000 acres in this area. (See map on page 11.)

The Company anticipates that the industry will spend in excess of $300 million, primarily in drilling, in the Arctic Islands through the period 1972 to 1976. In order to maintain a strong land position throughout this period of extensive exploration activity, Canadian Reserve will continue its independent exploration programs to evaluate certain of its more attractive land holdings, will participate in drilling where deemed advisable and

Left to Right—
Walter R. Jones, Staff Attorney
Thomas L. Deen, Assistant Secretary

will negotiate farmouts for exploration work by others.

In the Eastern Arctic where the Company is particularly well represented, the drilling of an estimated 10 wells has been announced by other operators.

A proposal for a 40 million dollar multiple well drilling program throughout the Arctic Islands, known as Drill Arctic, has been presented to industry. The Company is supporting this exploration project by making available for farmout through Drill Arctic certain permit lands on Devon Island. The program will become effective if the necessary drilling funds are committed by industry.

Eastern Canada Offshore: The offshore regions of Eastern Canada gained importance to the industry in 1971 because of the recently announced discovery by Mobil Oil Canada, Ltd. on Sable Island and the close proximity of the area to major refining facilities and marketing outlets along the eastern seaboard of North America.

Canadian Reserve owns a 100 percent interest in 6 million acres in the Gulf of St. Lawrence and offshore Nova Scotia. During 1971, a 1,200 mile marine seismic program was conducted by the Company as a preliminary evaluation of these substantial land holdings. As a

Canadian Reserve
Left to Right—Lorne D. Howes, Senior Geologist
R. Bruce Barley, Vice President-Exploration
Rudy C. Bertin, Chief Geophysicist
Donald M. McDonald, Vice President-Land

Acreage and Producing Wells

	Working Interest Acreage					Royalty Acreage		Oil and Gas Wells	
	Gross Acreage	Undeveloped Acreage		Developed Acreage					
		Gross	Net	Gross	Net	Gross	Net	Gross	Net
United States									
Alabama	13,640	—	—	13,640	34	—	—	251	.59
Texas	66,868	3,730	1,487	63,138	12,292	104,919	341	546	109.12
California	37,790	9,105	6,187	28,685	4,532	2,772	75	957	93.81
Illinois	10,206	51	13	10,155	385	3,814	332	335	5.43
Nebraska	5,929	320	240	5,609	2,535	9,880	893	25	11.25
Louisiana	4,160	3,735	894	425	319	—	—	9	6.00
Oklahoma	16,968	480	190	16,488	710	14,985	189	269	19.23
New Mexico	35,647	12,795	1,809	22,852	3,074	320	5	188	26.49
Wyoming	152,747	98,304	92,084	54,443	2,688	—	—	131	9.40
All Others	57,403	54,206	40,861	3,197	311	27,753	1,302	5	.49
Total	401,358	182,726	143,765	218,632	26,880	164,443	3,137	2,716	281.81
Canada/Alaska									
British Columbia	881,997	722,034	195,907	159,963	34,557	57,460	858	99	8.57
Alberta	922,545	867,416	194,825	55,129	20,802	188,444	4,691	707	34.78
Saskatchewan	527,393	479,056	171,554	48,337	11,186	627,824	1,338	1,717	192.17
Manitoba	24,946	22,008	1,341	2,938	1,356	—	—	321	14.66
Northwest Territories	2,066,725	2,066,725	1,572,540	—	—	2,434,875	58,290	—	—
Yukon Territory	1,890,632	1,890,632	1,201,313	—	—	351,228	9,431	—	—
Arctic Islands	11,438,068	11,438,068	9,007,343	—	—	1,412,455	37,924	—	—
East Coast	25,595,592	25,595,592	11,248,410	—	—	—	—	—	—
Alaska	10,321	10,161	6,398	160	30	26,067	947	1	.11
Total	43,358,219	43,091,692	23,599,631	266,527	67,931	5,098,353	113,479	2,845	250.29
Grand Total	43,759,577	43,274,418	23,743,396	485,159	94,811	5,262,796	116,616	5,561	532.10

Note: The above includes all acreage holdings and wells owned by Reserve, including Reserve's interest in exploration programs and joint ventures. Oil and gas wells include all producing wells and wells which were contributed to units.

result of the seismic program, preferred lands will be retained and the Company will proceed with further evaluation of these retained lands either for its own account or pursuant to satisfactory farm-out arrangements with other operators.

During 1971, several major oil and gas companies acquired exploratory permits in deep waters offshore Eastern Canada. The Company joined another independent Canadian company as a one-third owner and gained land representation in this trend, resulting in permit land holdings of 4.8 million gross (1.6 million net) acres off the south end of the Grand Banks and 14.7 million gross (4.9 million net) acres off the east coast of Labrador. Geophysical exploration will be carried out over the next 2 years on these land holdings to meet exploratory commitment obligations.

Transportation: In the heavy crude area of Saskatchewan, Canadian Reserve and Murphy Oil Company Ltd. own the 100 mile Lone Rock-Kerrobert pipeline system which transports crude oil-condensate blend from the producing areas at Lone Rock and Marshall south to Kerrobert into the interprovincial pipeline for delivery into Ontario and the Northwestern United States markets. Since the start-up of the system on April 1, 1971 some 1,600,000 barrels of blend have been transported to Kerrobert for delivery into the interprovincial pipeline with peak deliveries during October of 7,320 barrels per day. Canadian Reserve recently acquired an additional 7.5 percent interest in the system, increasing its ownership to 47.5 percent. Future pipeline operations are expected to add substantially to the Company's income as oil deliveries to the system increase as a result of exploration efforts and development of additional heavy crude reserves by the Company and other operators in the area.

Canadian Reserve:
Left to Right—Thomas M. Boyd, Manager of Operations, David W. Talbot, Secretary-Treasurer, Harold J. Gleusteen, Chief Engineer

Canadian Reserve owns a 21.67 percent interest in a 72 mile pipeline system in Northeast British Columbia which transports crude oil from the Aitken Creek, Blueberry and Inga Fields to Taylor Flats in British Columbia where the system connects with other pipeline systems to West Coast refineries. The jointly owned pipeline system, capable of handling 15,000 barrels per day, had an average daily thruput of 11,840 barrels in 1971 for a 2,080 barrel, or 21 percent increase, over 1970. Although thruput increased in 1971, net income to the Company for the two annual periods remained essentially equal at $85,000 due to annual tariff adjustments.

Natural Gas Processing: The Company owns varying interests (ranging from 0.67 to 33.3 percent) in five natural gas processing plants in Alberta.

The recently completed South Lone Pine Creek gas processing plant and related facilities, in which Canadian Reserve owns a 33.3 percent interest, was built at a cost of $5.5 million ($1.85 million to the Company's one-third interest). Sales from the plant commenced on December 7, 1971. The new facility provides a market for the sour gas reserves developed over the prior three years in the Devonian D-1 Formation underlying the Company's acreage in the South Lone Pine Creek Field. Upon development of additional reserves or increased demand for gas sales, the present 30 million cubic feet per day plant may be increased to 40 million cubic feet per day at a small incremental cost. Forecasts indicate the Company will produce, process and sell approximately 1.7 billion cubic feet of gas, 45,000 barrels of condensate and 9,400 long tons of sulphur from its property interests in the South Lone Pine Creek Field during 1972. (See map on page 8.)

The most significant plant interests of the Company are in the East Crossfield area where Canadian Reserve owns a 12 percent interest in gas processing facilities capable of handling 110 million cubic feet per day of sales gas from the Crossfield D-1 and Elkton units, in addition to a 7.7 percent interest in the D-1 sulphur recovery facilities and an 8.2 percent interest in the Elkton liquid recovery facilities. During 1971 the Company produced and sold from its Crossfield unit interests through the jointly owned processing facilities 2,540,200 MCF of gas, 71,264 barrels of condensate and produced 43,315 long tons of sulphur.

Mid-Continent Division

In 1971 an average of 2,479 barrels of crude oil, condensate and natural gas liquids per day and 14,046 MCF of gas per day were produced and sold from the Mid-Continent properties, net to the Company's interest before application to production payments. From funds generated by oil and gas sales, a total of $2,517,000 was applied to principal and $214,000 was applied to interest on the Mid-Continent Production Payments during 1971.

The major properties acquired by the Company in September 1963 in the Mid-Continent area were subject to previously existing production payments and additional production payments imposed at that time aggregating $22.3 million, as shown by the graph on page 24. As of January 1, 1972, this obligation had been reduced by $19.68 million, leaving a remaining $2.62 million production payment obligation. This final amount is projected to be paid off in December of this year, as the graph illustrates. As a result, the Company's net cash flow forecasts for 1973 and subsequent years show a very substantial increase.

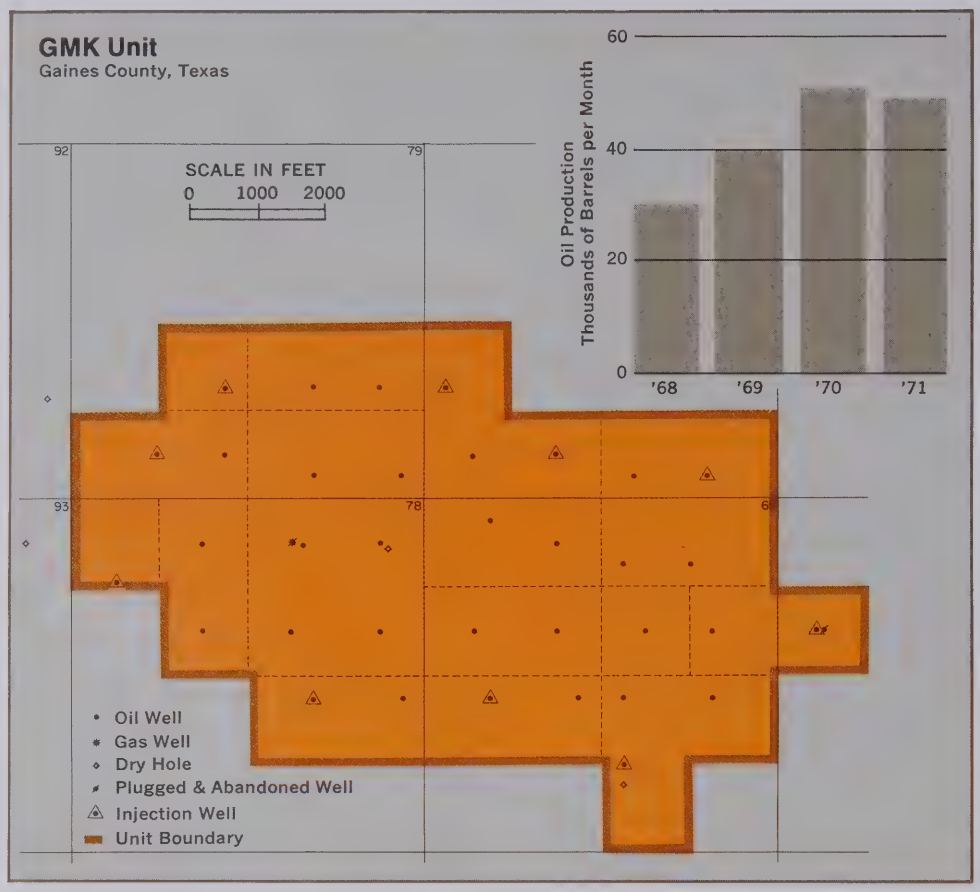
Major projects undertaken in the Division during the year are summarized below:

Kansas: The search for deep oil and gas reserves continues in Western Kansas where your Company owns a one-half leasehold interest in oil rights below 3400 feet under 19,360 acres and oil and gas rights below 3400 feet under an additional 2640 acres located in Finney, Haskell, Kearney and Seward Counties. Several wells were drilled near the Company's acreage during the year which have contributed to better geological control. It appears that at least two wells now in the planning stage will include company-owned acreage in the drillsite tract.

New Mexico: The Company, as Unit Operator, commenced water injection programs during the year in the Cooper Jal Unit containing 95 wells and in the South Langlie Jal Unit containing 27 wells. The producing formations in these two units include the Yates, Seven Rivers and Queens. Each formation has been receptive to successful water injection programs in the Lea County, New Mexico area. The Company's working interest in these units ranges from 22.59 percent in the Cooper Jal Unit to 40.08 percent in the South Langlie Jal Unit. At year end, the Company projected future net oil reserves of 1,070,000 barrels applicable to its unit interests in these two units which will generate a future net income of $2,173,000 to the Company over the life of the projects. The Company committed its interest to two additional non-operated unitized projects during 1971 and it is anticipated that water injection will commence during 1972.

Texas: The Company-operated GMK (San Andres) Unit located in Gaines County, Texas (see map on page 14) continued to respond to the water injection program but at a slightly reduced rate when compared to the performance during 1970.
This decrease resulted from one injection well accepting excessive volumes

Left to Right—John N. Pingree, Division Landman
John M. Penrod, Division Manager
M. Wyndell Thomas, Division Petroleum Engineer



of injected water into a small portion of the San Andres formation. This situation has been corrected and it is anticipated that the unit will experience continued favorable response during 1972. The Company owns a 34.4 percent average working interest in the unit and at year-end its future net oil reserves were projected to be 3,535,000 barrels which will generate a future net income of $8,916,000 to the Company over the life of the project.

The Company owns a 10.12 percent working interest in the Reeves (San Andres) Unit, containing 121 wells, located in Yoakum County, Texas (see map on page 15). A water injection program was commenced in 1965 and the response to the program has increased during 1971, and it is anticipated that the oil production rate will increase substantially during 1972. At year-end the future net oil reserves were projected to be 2,311,000 barrels which will generate a future net income of $5,964,000 to the Company over the life of the project.

Western Division

General: During 1971 the Company's net share of production remained substantially unchanged with an average monthly production rate of 43,500 barrels of oil and 161,000 MCF of gas, for a yearly net revenue to the Company of $2,520,000. The maintenance of these production rates was made possible by production increases which compensated for normal field declines. These increases resulted from new wells, and the completion of a number of well remedial and stimulation jobs. In spite of inflationary trends, it was possible to reduce production operating expenses by 8 percent through the application of improved operating techniques. Operational highlights in some of the Western Division Fields are discussed below.

California

Wilmington Field: Reserve participated in redrilling four wells including three producers and one injector. Extensive remedial and stimulation work was done on existing wells to improve performance in both the Fault Block IV and V units. Experimental Polymer injection was continued in the latter unit and its long-range application is under study. 110,156 barrels of oil were produced from these units in 1971 to Reserve's interest.

Tejon Area: Reserve joined in the drilling of five wells in the South Central Tejon Field. Two were unsuccessful step-outs in the easterly block, and these appear to define the limits of the reservoir in that area. The other three were completed in the central portion of the field for an initial production of 210 B/D of 21° gravity oil. Reserve owns a 25 percent working interest in these wells.

In October a major oil company committed to the expenditure of substantial sums of money for seismic exploratory operations in the Tejon Embayment in consideration of two options to drill one or more deep test wells following completion of their geophysical survey. Early this year this company committed to the drilling of one deep test at a location not yet specified. This well will be commenced prior to the middle of March. The other option has not been exercised as yet.

Sherman Island Gas Field: Reserve joined Signal Oil and Gas Company and others in drilling a directional well under the Sacramento River in an effort to obtain additional gas production. However, the objective zones were encountered structurally low and the effort was unsuccessful.

Left to Right —
Robert P. Mangold, Manager, Western Division
Marshall C. Turner, Manager of Operations

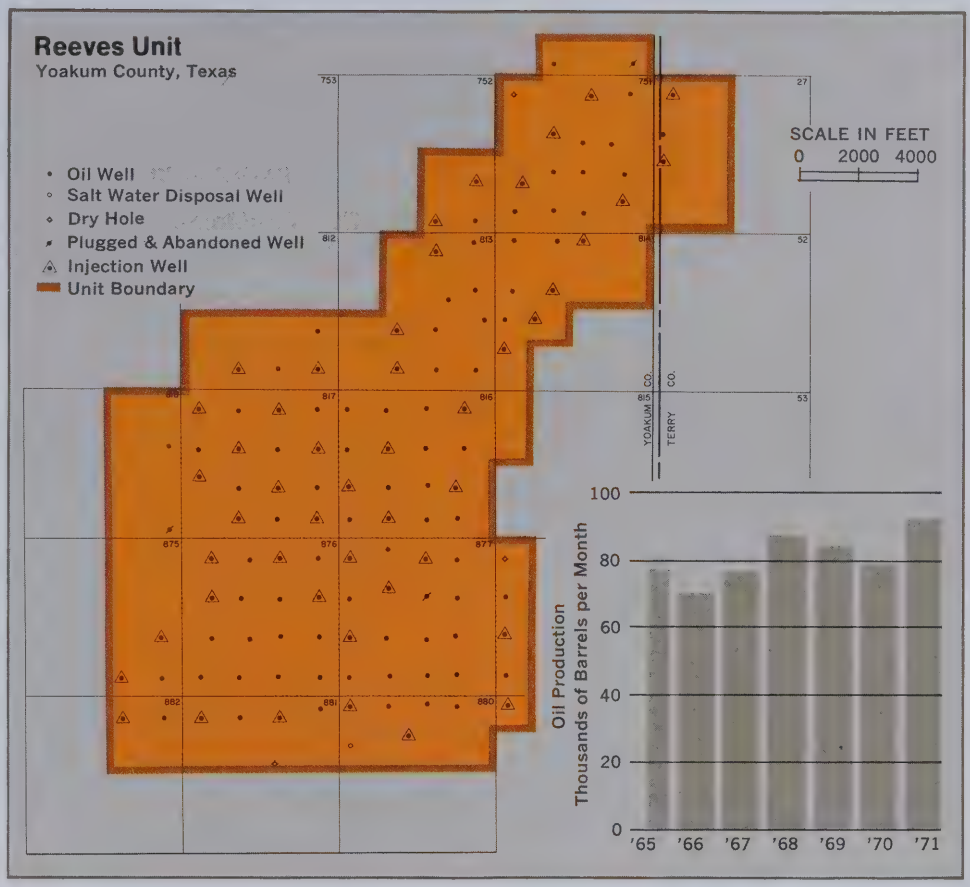
Moon Bend Gas Field: In August, 1971 the Company purchased a 208 acre lease in Colusa County, California on which a productive well had been drilled earlier in the year. On initial production tests from an interval of 6482 feet to 6530 feet the well indicated a potential producing rate of 1810 MCF per day with 1740 psi flowing tubing pressure. The well has been connected to a sales outlet and the gas production is being sold under contract. Reserve has a 100 percent working interest in this well until payout and a 50 percent interest thereafter. Additional development of the lease is under consideration.

Banta Station Gas Field: Two new productive wells, in which Reserve has a 25 percent working interest, were completed in 1970 and were connected to a sales outlet in 1971. Production from these wells is being sold under a long-term contract. During the second half of 1971 37,874 MCF were produced to Reserve's interest in these wells, which averages 22 percent. Additional development drilling will be undertaken in the southern part of this field this year. Reserve has a 25 percent interest in approximately 480 acres where this drilling will occur.

Wyoming

Cottonwood Creek Unit: The Company participated in the drilling of seven infill wells in the limestone reservoir which is under water flood. All of these wells were successful completions. There are now 49 producing wells and 15 injection wells in this unit. During December of 1971 the unit produced an average of 2,016 barrels per day of 27° gravity oil and 548 MCF of gas per day. Reserve's interest in this unit is 2.5 percent.

House Creek Field: Woods Petroleum Corp. completed a well (Wroble Federal #1) on Company lease property in November for 180 B/D of 38° gravity oil. Reserve has a 7½ percent overriding royalty in this well until payout, after which it will have a 50 percent working interest; and a 50 percent working interest in the remainder of the lease which comprises a total of 320 acres. Additional development drilling on the lease or under a unit arrangement with adjacent leases is under consideration.



Halbouty-Reserve U.S.A. Exploration Program

The Program Participant has committed an additional $2 million in exploratory funds for 1972.

During 1971 the Program participated in the drilling of 10 new prospects located in Louisiana, Montana, Wyoming, California and Texas, resulting in the discovery of a new gas distillate field. In November, the No. 1 Walker was completed as a new field discovery in the Frio sand. The well is located 1½ miles northwest of the East Bell City Field in Calcasieu Parish, Louisiana. It was perforated in the interval of 10,888 feet to 10,894 feet and flowed at the rate of 2,775,000 cubic feet of gas and 31 barrels of 52° gravity condensate through a 15/64" choke with 1760 psi flowing tubing pressure. The Program owns a 43.75 percent working interest in the well until payout and a 30.6 percent interest thereafter. The Program owns working interests varying from 30.6 to 32.8 percent in the balance of its 1,000-acre block.

In 1971 an additional development well was drilled in the South Opelousas Field in St. Landry Parish, Louisiana and was completed in the Frio sand. This makes a total of 6 productive wells in this field. The Program owns 100 percent of the working interest in this latest development well.

Reserve owns a 15 percent net profits interest in this Program.

Left to Right—Ben L. Morris, Staff Engineer. William A. Boothe, Area Production Superintendent, Joe L. Cowdrey, Division Geologist

Apple Valley Ranchos

The real estate development business conducted by Reserve's Apple Valley Ranchos Division in the high desert resort area in southern California continued its substantial contribution to your Company's total revenues, cash flow and earnings in 1971.

Gross revenues from Apple Valley Ranchos operations totaled $4.6 million in 1971. These revenues were primarily provided by subdivided property sales and also included commission income from the sale of property owned by others, interest on land sales contracts, revenues from hotel operations and public utility water sales. Real estate sales in 1971, including sales of subdivided property for others under exclusive sales agency contracts, amounted to $2.2 million, down from $3.1 million of such sales reported in the previous year. The sales decline in 1971 is believed attributable to unfavorable general economic conditions prevailing in southern California during the year.

Apple Valley experienced an increase in residential construction as interest rates eased in 1971. Total housing starts increased to 107 units during the year and compares with 86 structures started in 1970 and 71 started in 1969. While your Company does not engage in the construction business, such activity in the Apple Valley area has an obvious beneficial effect upon Reserve's real estate holdings. Your management continues its optimism in the growth prospects of the 3,000-foot Apple Valley area with its abundance of fresh, sparkling air, its crystal clear water and panoramic vistas. This natural endowment combined with management's carefully developed master plan which provides for spacious homesites, open areas and architectural control has created one of the country's finest casual living environments.

Your Company's Apple Valley Inn, a well-known desert resort hotel containing 101 guest rooms, benefited from a modernization and renovation program in 1971. The primary features of this $400,000 project included the modernization and refurnishing of two of the main dining areas and the renovation of 37 guest rooms. This resort facility offers a variety of activities to visiting guests including golf, horseback riding, tennis, outside western steak-frys and swimming, all in ideal year-round climate. Your management plans to continue its improvement program in 1972.

Apple Valley Ranchos added 125 multiple and residential parcels to the Company's subdivided lot inventory in 1971 through the development of the Kiowa Park No. 7 subdivision. This well-located property is situated off of Bear Valley Road, a primary traffic artery, and is close to both the Apple Valley Senior High and the Apple Valley Junior High Schools. Substantial development work was accomplished in Apple Valley Ranchos Desert Knolls Manor No. 2 subdivision in 1971. This hillside subdivision located near the Mojave River Narrows will contain approximately 350 lots and will be opened for sale in mid-1972. In addition to subdivision development, your Company purchased 272 acres of land for future subdivision development. One of these properties, a 214 acre parcel, is located close to the banks of the Mojave River and is in an area that will be important in the future development of the valley. Your Company's undeveloped holdings of approximately 8,000 acres of raw land will play a significant role in the accelerating rate of growth of the Apple Valley area.

In other developments in the Apple Valley area, nearby George Air Force Base celebrated its 30th anniversary in 1971. This important facility, which is noted for its near-perfect year-round flying weather, is a focal point for the activities of 14,000 people, including

Walter E. Cramer, Jr., Vice President

dependents, and has an annual payroll of $40 million. In addition, it has a plant valuation of $400 million and a current construction budget of approximately $8 million.

The General Electric modular housing factory located in Apple Valley has completed 200 housing units for George Air Force Base, and is presently involved in the construction of 250 units for Norton Air Force Base near San Bernardino. This Apple Valley facility presently has a roster of 175 employees. The new housing construction concepts developed in this operation have proved highly successful and are receiving national attention.

Air passenger service to Apple Valley is provided by Hughes Airwest to the modern Apple Valley Jet Airport four times daily. A recent announcement by the airport manager indicates that a restaurant facility will soon be provided on the premises.

Apple Valley's 73-bed St. Mary Desert Valley Hospital constructed a new 4,000 square foot coronary and intensive care unit in 1971. This modern $250,000 addition will provide for the constant electronic monitoring of the patient's heart and other reactions on a continuous basis.

The Victor Valley College near Apple Valley was recently accredited for a five year period. This enables the 2,400 students to receive full credit for courses taken when they transfer to other colleges. The college operates on a $2 million annual budget and is housed in a $6 million facility. Many of the courses are designed to prepare students for local employment and include courses in business, agriculture, trade and vocational subjects, as well as general academic areas. The aeronautic department is especially noteworthy as this is the only state school in southern California where students can receive training and certification as licensed F.A.A. airplane mechanics.

The Cedar Springs Dam, a part of the statewide Feather River Water Project, was completed in early 1971 and water is currently flowing into the newly created Silverwood Lake. The 215 foot high earth and rockfill dam and lake with a shoreline of 13.4 miles is located less than 20 miles from the heart of Apple Valley. Temporary recreational facilities at the north end of the lake are scheduled to be opened to the public in mid-1972. As the surface area of the lake expands from 650 surface acres in 1972 to 1,000 surface acres in 1973, new permanent recreational facilities for 2 million visitor days per year will be available and will include boat launching ramps, a swimming beach and camp and camping trailer sites. The nearby $17 million Mojave Forks Reservoir Dam was dedicated in 1971 and recreational development is currently in progress. Also dedicated in 1971 was the new 800 acre Mojave Narrows Regional Park, located adjacent to Apple Valley. The park contains several small lakes, and is currently open to the public for fishing, boating and picnicking. Additional development is in progress to provide camping and swimming. This recreational and wildlife attraction is designed to accommodate 500,000 visitor-days a year. The opening of these new water areas further broadens the recreational facilities available to Apple Valley residents.

Left—Newton T. Bass, Chairman of the Board

James R. Jones, Mike C. Meeken, Sales Executives

Mohawk Petroleum Corporation, Inc.

Mohawk Petroleum Corporation, Inc., one of California's oldest independent oil refining and marketing companies, became a wholly-owned subsidiary of Reserve in 1969. During 1971 it again contributed substantially to Reserve's profits, cash flow and increases in working capital. Sales of gasoline, your company's largest dollar-volume product, increased 29 percent over 1970, to 103,039,867 gallons, an average of over 8,500,000 gallons per month, largest gasoline sales in the company's history. In addition to increases by each of the company's three marketing divisions—the Northern Division headquartered in San Francisco, the Central Division in Bakersfield, and the Southern Division in Los Angeles—the Mohawk brand was introduced for the first time into Arizona through arrangements with a new distributor, the Shay Oil Co. of Yuma.

As a result of this new affiliation, along with new arrangements with other distributors and dealers in California, 31 additional Mohawk branded service stations were added to our existing retail marketing outlets in 1971. In addition, the company financed construction of an additional 18 retail outlets selling re-branded products on property owned and operated by Dairy Drive-Ins, Convenience Food Marts and Liquor Stores. As a result of this expansion along with the acquisition of other new accounts, and after the closing of 6 small unprofitable branded stations in Northern California, company products at year-end were being marketed through 241 retail outlets (up from 191 in 1970 and 183 in 1969) comprising 143 service stations selling Mohawk branded products and 98 outlets selling Mohawk products re-branded to other tradenames, plus 90 commercial customers and wholesale accounts, located in 136 cities and towns in the states of California, Arizona and Nevada.

Malcolm McDuffie, President

Profitable gallonage increases during 1971, achieved in the face of increasing California land and construction costs, have confirmed the desirability of continuing emphasis on the relatively new but rapidly expanding concept of marketing gasoline through low-cost installations in connection with small, consumer-oriented merchandising businesses. Since it appears that this approach offers greater returns to the company in relation to investment than the construction and development of conventional service stations, the company has budgeted for continued expansion in this manner during 1972.

Mohawk continued to serve the San Joaquin Valley as an important manufacturer and supplier of quality diesel oil. During 1971 the company sold 34,034,749 gallons of this fuel to truck operations, farmers, other refiners and to a nationwide railroad on whose mainline the Bakersfield refinery is located. In addition, the company sold 22,408,218 gallons of jet fuel to the Defense Fuel Supply Agency for use by United States military forces.

In November, the Southern Marketing Division moved into its new headquarters at Carson, California, a modern office building, warehouse and truck yard designed, constructed and owned by the company. This attractive building is centrally located a few miles south of Los Angeles adjacent to points of supply and enjoys easy freeway access for

Operating Highlights 1971

Refinery Thruput	5,977,752 Barrels	16,377 Barrels per Day
Gasoline Sales	103,039,867 Gallons	8,586,655 Gallons per Month
Diesel & Stove Oil Sales	34,791,832 Gallons	2,899,319 Gallons per Month
Jet Fuel Sales	22,408,218 Gallons	1,867,351 Gallons per Month
Retail Products Outlets at December 31, 1971	241	

New headquarters of Southern Marketing Division at Carson, California

distribution to all of the company's retail outlets, distributors and commercial accounts in Southern California. Your management believes that this modern facility, which provides attractive, well-designed working space for administering operations of the Southern Division's 200 employees, and which incorporates highly efficient computerized record-keeping equipment, will add materially to the productivity and efficiency of this important marketing group.

During 1971, Mohawk's refinery at Bakersfield, California completed its 40th year of continuous operation, processing some 5,977,752 barrels (16,377 B/D) of high gravity San Joaquin Valley crude oils supplied under contracts with a major oil company, the United States Navy and numerous independent producers. A large proportion of the refined products produced and blended at the refinery is delivered through pipelines for distribution throughout Central California, in exchange for comparable refined products delivered to Mohawk for distribution in Northern and Southern California. In July, the bimetallic catalyst in the refinery's 2,600 B/D Platformer, a catalytic reforming unit designed to convert naphtha into high-octane platformate for blending into premium gasoline, was replaced after three years' continuous operation during which time it processed 300 barrels of naphtha per pound of catalyst without a single regeneration, believed to be a new industry record.

During 1971 the company received licenses to import, and imported 2,537,480 barrels of foreign crude and unfinished oils, an average of 6,952 B/D. Mohawk delivered this imported crude at points of importation in exchange for San Joaquin Valley crude oil delivered by pipeline into the refinery. During 1971, posted prices for Persian Gulf crude oils were increased, resulting in higher costs for this portion of Mohawk's raw materials. For 1972, your company's import license totals 2,858,826 barrels, an average of 7,811 B/D.

Mohawk, as well as the refining industry in general, continues to await resolution and clarification of environmental regulations affecting ambient air standards, automobile emissions, and fuel composition before embarking on programs of modernization and expansion to meet the continually growing market demands in California. It is essential that realistic, responsible and achievable goals be established by regulatory authorities. Further, it is particularly important that the responsibility for establishing such regulations be coordinated among Federal, State and County authorities. Your company's management remains confident that a common-sense balance will ultimately prevail between necessary environmental controls on one hand and the requirements for energy and interests of the consumer on the other.

Left to Right—Jack J. Reed, Vice President, Southern Marketing Division, J. P. D'Arienzo, Controller, Clay Thompson, Vice President, Refining, L. W. Friedman, Vice President, Supply and Refinery Sales, Arvid Norman, Vice President, Northern Marketing Division

Consolidated Balance Sheet

December 31, 1971 and 1970

Assets	1971	1970
Current assets:		
Cash—including certificates of deposit of $1,050,000	$ 2,778,712	$ 3,755,262
Marketable securities, at cost which approximates market	1,712,081	1,950,909
Accounts receivable	5,953,126	5,139,875
Installment contracts, commissions and notes receivable	1,505,340	1,677,416
Inventories, at lower of cost or market	3,756,930	2,909,313
Prepaid expenses	1,199,054	916,064
Total current assets	16,905,243	16,348,839
Investments and long-term receivables:		
Installment contracts, commissions and notes receivable	8,433,071	8,407,762
Undeveloped land and other investments, at lower of cost or market	1,062,290	862,965
	9,495,361	9,270,727
Properties, at cost:		
Oil and gas properties	76,409,731	68,953,903
Refining, manufacturing and distributing facilities	11,506,721	11,094,483
Commercial and other properties	6,669,786	6,152,209
	94,586,238	86,200,595
Less accumulated depletion and depreciation	40,535,186	37,809,687
	54,051,052	48,390,908
	$80,451,656	$74,010,474

Liabilities and Shareholders' equity		
Current liabilities:		
Notes payable, current portion	$ 18,400	$ 111,150
Accounts payable and accrued liabilities	6,032,596	5,625,398
Total current liabilities	6,050,996	5,736,548
Notes and other long-term payables	7,967,757	8,464,606
Deferred Canadian income taxes	675,000	500,000
Deferred income:		
Carved out production payments	—	1,779,450
Commissions receivable	2,119,517	2,511,880
	2,119,517	4,291,330
Minority interest	2,642,282	—
Shareholders' equity:		
Capital stock:		
Convertible preferred stock, $25 par and involuntary liquidating value: authorized 400,000 shares; 1971—issued 310,819 shares (including 2,558 treasury shares)	7,770,475	7,788,825
Common stock, $1 par value: authorized 15,000,000 shares; 1971—issued 9,334,065 shares (including 6,041 treasury shares)	9,334,065	9,332,398
Capital surplus	16,987,150	14,241,942
Retained earnings	26,956,475	23,706,886
Treasury stock, at cost, 2,558 shares Series B preferred shares and 6,041 common shares	(52,061)	(52,061)
Total shareholders' equity	60,996,104	55,017,990
	$80,451,656	$74,010,474

See accompanying Financial Review.

Consolidated Statement of Operations and Retained Earnings

Years ended December 31, 1971 and 1970

	1971	1970
Revenues:		
Petroleum product sales	$42,729,407	$37,130,867
Real estate sales and commission income	2,917,796	3,513,189
Other income—including interest income: 1971—$805,991, 1970—$707,049	2,893,688	2,804,108
	48,540,891	43,448,164
Costs and expenses:		
Cost of petroleum products sold and operating expenses	31,601,095	25,315,813
Cost of real estate sold and provision for loss on repossessions	1,140,980	1,167,735
Selling and administrative expenses	6,919,409	7,793,825
Dry hole costs	59,726	246,397
Depletion, depreciation and abandonments	4,043,391	3,643,823
Interest expense	707,786	1,006,216
Minority interest	185,660	—
Federal, state and Canadian income taxes	209,083	665,161
	44,867,130	39,838,970
Income from continuing operations	3,673,761	3,609,194
Loss from discontinued operations, less allocated tax benefit	—	(715,682)
Income before extraordinary items	3,673,761	2,893,512
Extraordinary items:		
Income tax credit related to prior year's sale of oil and gas property	—	95,928
Provision for loss on disposition of fertilizer plant, less deferred tax credit—$1,876,467	—	(5,473,533)
Net income (loss), for the year	3,673,761	(2,484,093)
Retained earnings, beginning of year	23,706,886	26,618,520
Dividends paid on preferred stock	(424,172)	(427,541)
Retained earnings, end of year	$26,956,475	$23,706,886
Per share of common stock:		
Income from continuing operations	$ .35	$ .34
Loss from discontinued operations	—	(.08)
Extraordinary items	—	(.57)
Net income (loss) applicable to common stock	$ .35	$(.31)

See accompanying Financial Review.

Consolidated Statement of Changes in Financial Position

Years ended December 31, 1971 and 1970

Source of funds:	1971	1970
Operations:		
Income before extraordinary items	$ 3,673,761	$ 2,893,512
Charges (credits) to income before extraordinary items, not involving working capital:		
Depletion, depreciation and abandonments (including $563,123 applicable to discontinued operations in 1970)	4,043,391	4,206,946
Revenue from land sales (due after one year) less $432,626 ($637,162 in 1970) provision for loss on repossessions	(1,191,578)	(1,446,357)
Other	338,388	284,253
Total from operations	6,863,962	5,938,354
Collections on installment contracts and other long-term receivables	1,186,970	873,674
	8,050,932	6,812,028
Proceeds from sale of stock by subsidiary	5,904,036	—
Proceeds from loans	2,282,725	4,223,664
Proceeds from sale of properties	812,588	168,067
Other	486,923	602,274
	17,537,204	11,806,033
Disposition of funds:		
Additions to properties	9,028,040	4,829,711
Principal applications to production payments	3,282,388	4,150,945
Payments and other decreases in long-term liabilities	3,914,263	657,894
Additions to notes and long-term receivables	437,379	121,824
Dividends paid on preferred stock	424,172	427,541
Other	209,006	249,202
	17,295,248	10,437,117
Increase in working capital	$ 241,956	$ 1,368,916

See accompanying Financial Review.

Financial Review

Earnings and revenues: Reserve's consolidated net income in 1971 amounted to $3,673,761, equal to $ .35 per share on the 9,327,755 average common shares outstanding during the year. In 1970, your Company reported a net loss of $2,484,093 ($ .31 per share) which included a loss from discontinued fertilizer manufacturing operations of $715,682 ($ .08 per share) and extraordinary items, primarily provision for loss on disposition of the Hanford Fertilizer Plant, of $5,377,605 ($ .57 per share).

Reserve's revenues from continuing operations reached a record high in 1971 of $48,540,891, an increase of 12% over revenues of $43,448,164 reported in 1970.

Changes in financial position: Funds generated from your Company's operations and collections on installment contracts and other long-term receivables amounted to $8,050,932 in 1971 and compares with funds so generated of $6,812,028 in 1970. Other funds provided included $5,904,036 received from the sale of common stock of Canadian Reserve and $2,282,725 borrowed primarily under bank credit agreements. Major expenditures of funds included $9,028,040 for additions to properties, $3,914,263 for debt retirement and $3,282,388 for production payment principal applications.

Working capital amounted to $10,854,247 at the end of 1971, and compares with $10,612,291 at the end of 1970. The changes in the various elements of working capital are as follows:

	1971	1970
	(In Thousands)	
Increase (decrease) in current assets:		
Cash	$(977)	$ 706
Marketable securities	(239)	(793)
Accounts receivable	813	(805)
Installment contracts, commissions and notes receivable	(172)	(159)
Inventories	848	(252)
Prepaid expenses	283	(102)
	556	(1,405)
Increase (decrease) in current liabilities:		
Notes payable, current portion	(93)	(889)
Accounts payable and accrued liabilities	407	(1,885)
	314	(2,774)
Increase (decrease) in working capital	$ 242	$ 1,369

Installment contracts, commissions and notes receivable: These receivables totaled $9,938,411 at the end of 1971 compared with $10,085,178 at the end of 1970, after an allowance for loss of $1,486,504 in 1971 and $1,727,588 in 1970. Reserve records income from land sales on the accrual basis upon receipt of a down payment (averaging 14% in 1971) and execution of a contract. The contracts are generally for twelve years and are secured solely by the land sold. Reserve also earns commissions on sales of land owned by others and, as the Company has no enforceable claim against the buyer or original owner, such commissions are recorded as income when collected.

Inventories at the end of 1971 and 1970 are as follows:

	1971	1970
	(In Thousands)	
Petroleum products, at average cost	$1,613	$1,081
Chemical products, and in 1970, fertilizer, at lower of average cost or market	263	639
Subdivided land, at cost	1,288	790
Materials and supplies, at or below average cost	593	399
	$3,757	$2,909

Properties: Oil and gas exploration expenses including geological and geophysical costs, delay drilling rentals and dry hole costs are expensed as incurred, except for such costs incurred by Reserve's Canadian subsidiary which, beginning January 1, 1971, are capitalized and amortized under the full-cost method of accounting. Costs of acquiring non-producing mineral rights are capitalized and charged to expense when surrendered, except for Canadian costs which beginning January 1, 1971 are capitalized and amortized. The effect of changing to the full-cost method for Canadian operations is to increase 1971 income by $540,000 ($.06 per common share).

Reserved production payments are added to the cost of acquired properties. The unpaid balance of the production payments, $2,625,709 in 1971 ($5,143,772 in 1970), is payable solely out of production from certain properties and is deducted in arriving at the carrying value of such properties. Sales of $2,881,614

Robert E. Aberley, Treasurer, Gene P. Gates, Controller

Company's Net Share Oil and Gas Sales—1971	Crude Oil and Natural Gas Liquids—Bbls.	Dry and Casinghead Gas—MCF
Texas	643,332	4,479,380
California	302,698	1,474,371
Wyoming	209,812	522,797
Louisiana	84,133	—
Nebraska	75,922	—
Illinois	46,134	—
New Mexico	30,583	444,602
Oklahoma	22,024	76,207
Saskatchewan	1,339,010	121,013
Alberta	439,823	4,654,087
British Columbia	231,385	555,310
Manitoba	98,232	—
All Others	11,363	126,740
Totals	3,534,451	12,454,507
Average per day	9,683	34,122

Note: The above tabulation includes production applied to the retirement of production payments.

in 1971 ($3,083,453 in 1970) and interest expense of $214,441 in 1971 ($379,638 in 1970), which were applied to reduce the unpaid balance of production payments, are included in the consolidated statement of operations.

Depletion and depreciation of the costs of oil properties and related equipment and amortization of capitalized intangible drilling costs are computed on the unit-of-production basis; buildings and other equipment are depreciated by the straight-line and declining-balance methods at rates varying from 2½% to 33⅓% per annum.

Notes and other long-term payables: At December 31, 1971, long-term debt amounted to $7,967,757, a decrease of $496,849 from the $8,464,606 payable at December 31, 1970. Long-term debt consisted of the following:

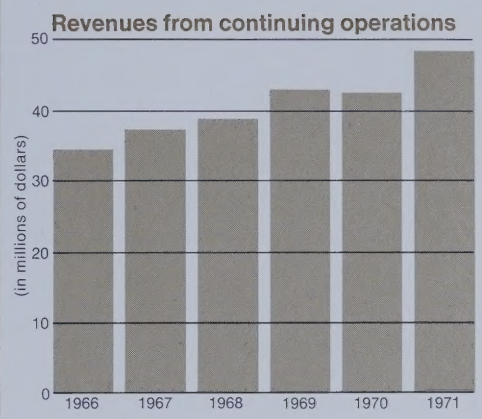
	1971	1970
	(In Thousands)	
Notes payable to bank, at ½% above prime:		
Due $500,000 quarterly beginning March 31, 1973	$6,100	$4,930
Production loan due 1973 to 1976	992	—
Production loan paid in 1971	—	2,750
Other	876	785
	$7,968	$8,465

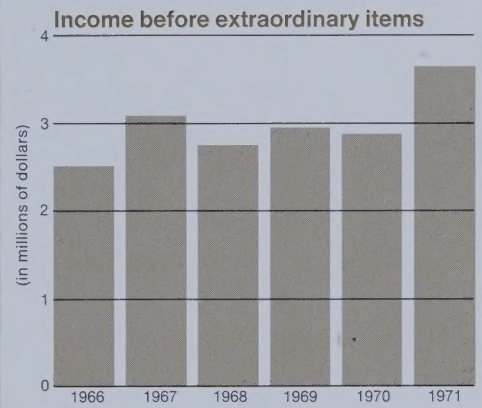
One of the bank debt agreements requires, among other things, the maintenance of a minimum net worth, working capital equal to 10% of defined net worth, and prohibits the payment of cash dividends on Reserve's common stock.

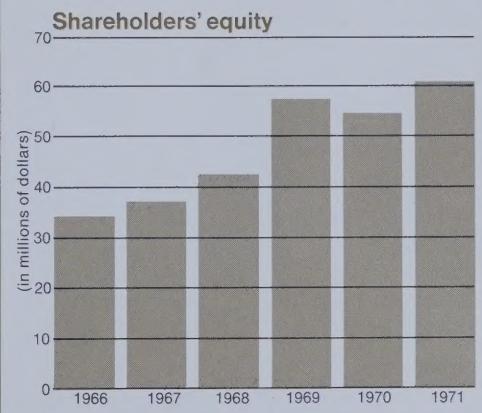
Stock-option plans: Reserve has several stock-option plans for officers and key employees, approved by stockholders at various times, under which options may be granted at the market price at the date of grant, but cannot be exercised until at least one year after date of grant. At December 31, 1970, options were outstanding for 223,500 shares of the Company's common stock and 88,500 shares were available for the granting of additional options. During 1971, options for 6,000 shares were granted and options for 6,500 shares were cancelled. At December 31, 1971, options were outstanding for 223,000 shares at prices ranging from $5.875 to $17.75 per share, an aggregate of $2,547,385. At that same date, options for 217,000 shares were exercisable and 89,000 shares were available for the granting of future options.

In addition, Canadian Reserve has granted to certain of its officers and employees options to purchase 135,500 shares of its capital stock at an aggregate price of $670,725. At December 31, 1971, 64,500 shares were available for the granting of future options.

Capital stock: Reserve has shares of four series of 5½% cumulative, convertible, voting (except Series C), preferred stock outstanding at December 31, 1971 as follows: Series A—23,799, Series B—103,830 (includes 2,558 treasury shares), Series C—9,600 and Series D—173,590. Such shares are convertible







Six Year Statistical Summary of Consolidated Operations

Financial: Amounts in thousands of dollars	1971	1970	1969	1968	1967	1966
Revenues (from continuing operations)	$48,541	$43,448	$43,503	$38,848	$37,792	$34,345
Income before extraordinary items	3,674	2,894	2,959	2,758	3,095	2,530
Extraordinary credits (charges)	—	(5,378)	1,423	333	228	111
Net income (loss)	3,674	(2,484)	4,382	3,091	3,323	2,641
Net income (loss) per common share	.35	(.31)	.44	.33	.37	.28
Working capital	10,854	10,612	9,243	10,066	10,198	8,165
Reserved production payments outstanding	2,626	5,144	7,689	10,243	12,852	15,672
Shareholders' equity	60,996	55,018	57,989	42,808	37,310	34,380
Total assets	80,452	74,010	80,008	74,548	70,773	55,453
Other:						
Average common shares outstanding (in thousands)	9,328	9,324	8,933	8,028	7,813	7,804
Crude oil and natural gas liquids production, barrels per day	9,683	9,734	9,706	9,375	9,110	8,402
Natural gas sales, Mcf per day	34,122	35,363	40,053	37,996	37,853	39,674

Note: 1971 reflects use of full-cost method of accounting for exploration costs of Canadian subsidiary. See financial review.

into common stock at various rates and are callable by the Company at various times and at amounts up to 106% of par value.

Regular quarterly dividends were paid in 1971 on the four issues of preferred at the rate of $1.375 per share aggregating $424,172.

During 1971, 734 shares of preferred stock (2,650 in 1970) were converted into 1,667 shares of common stock (7,031 in 1970). At December 31, 1971, 1,033,582 shares of common stock were reserved for issuance as follows: 613,978 shares for conversion of preferred stock; 312,000 shares in connection with stock options; and 107,604 shares in connection with warrants arising out of 1969 poolings-of-interests, exercisable at $13.94 per share through September 15, 1974.

Capital surplus: In February 1971, Canadian Reserve sold 1,000,000 new shares of its common stock to the Canadian public for cash which reduced Reserve's ownership to 89.5%. As a result of the sale, Reserve increased capital surplus by $2,728,525. Capital surplus was also increased by $16,683 ($59,219 in 1970) as a result of conversions of preferred stock.

Income taxes: Reserve provides for deferred income taxes applicable to transactions which affect book and taxable income in different years (principally, depreciation and installment sales of land and oil and gas properties). No provision for deferred tax is made for differences of a permanent nature such as those arising from statutory depletion and intangible development costs. In consolidation, Reserve eliminated $169,535 ($83,879 in 1970) of deferred Canadian taxes to conform with Reserve's method of accounting.

General: Accounts of all wholly- and majority-owned subsidiaries are included in the consolidated financial statements. The accounts of Canadian Reserve have been converted to U.S. dollars at appropriate rates of exchange.

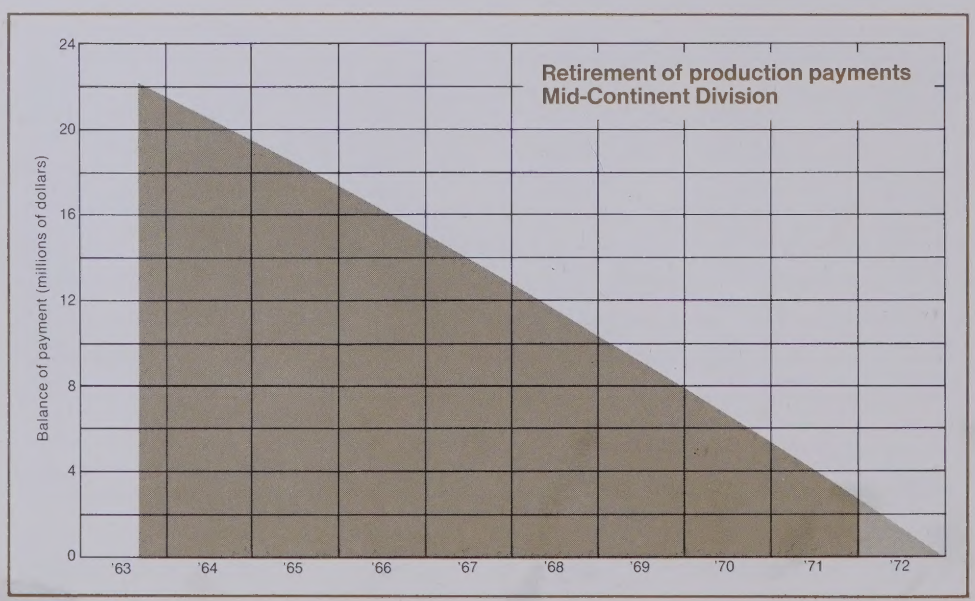
Intercompany transactions have been eliminated.

Net income (loss) per share of common stock is based on the weighted average shares outstanding and net income (loss) after deduction of preferred dividend requirements. Assuming conversion of outstanding preferred stock and exercise of outstanding stock options and warrants at the beginning of the year, there would have been no dilution of the per-share results.

Wells Drilled

	Gross Wells		Net Wells	
	1971	1970	1971	1970
Development:				
Producers	74	49	10.88	14.44
Dry Holes	9	8	2.72	2.00
	83	57	13.60	16.44
Exploration:				
Producers	15	12	5.06	4.09
Dry Holes	41	42	11.28	8.28
	56	54	16.34	12.37
Total Wells:	139	111	29.94	28.81

Success Ratios:	Development	89.2%	86.0%
	Exploration	26.8%	22.2%



Accountants' Report

ARTHUR YOUNG & COMPANY

CROCKER PLAZA
POST AT MONTGOMERY
SAN FRANCISCO, CALIFORNIA 94104

The Board of Directors and Shareholders
Reserve Oil and Gas Company

We have examined the accompanying consolidated balance sheet of Reserve Oil and Gas Company at December 31, 1971 and the related consolidated statements of operations and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have previously made a similar examination of the consolidated financial statements for the prior year.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Reserve Oil and Gas Company at December 31, 1971 and December 31, 1970, the consolidated results of operations and the consolidated changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period, except for the change, to which we do not object, in the method of accounting for exploration and development costs incurred in Canada as described in the Financial Review under "Properties."

February 11, 1972

Arthur Young & Company

Principal Subsidiaries

CANADIAN RESERVE OIL AND GAS LTD.
639 - 5th Avenue, S.W., Calgary 1, Alberta, Canada
Paul D. Meadows, President

MOHAWK PETROLEUM CORPORATION, INC.
550 S. Flower Street, Los Angeles, California 90017
Malcolm McDuffie, President

Division and Other Offices

EXECUTIVE OFFICES:
550 S. Flower Street, Los Angeles, California 90017

APPLE VALLEY RANCHOS DIVISION
P.O. Box 1, Apple Valley, California 92307
Walter E. Cramer, Jr., Vice President

MID-CONTINENT DIVISION
1806 Fidelity Union Tower, Dallas, Texas 75201
John M. Penrod, Manager

WESTERN DIVISION
2011 18th Street, Bakersfield, California 93301
Robert P. Mangold, Manager

Transfer Agents

SECURITY PACIFIC NATIONAL BANK, Corporate Trust Division
124 West Fourth Street, Los Angeles, California 90013

THE CHASE MANHATTAN BANK, N.A.
One Chase Manhattan Plaza, New York, New York 10015

GUARANTY TRUST COMPANY OF CANADA, 311 - 8th Ave., S.W.
Calgary, Alberta, Canada

Registrars

THE BANK OF CALIFORNIA, N.A.
550 S. Flower Street, Los Angeles California 90017

FIRST NATIONAL CITY BANK
55 Wall Street, New York, New York 10005

GUARANTY TRUST COMPANY OF CANADA, 311 - 8th Ave., S.W.
Calgary, Alberta, Canada

Stock Exchange Listings

American Stock Exchange
Pacific Coast Stock Exchange

Shareholders and Employees

SHAREHOLDERS 20,165
EMPLOYEES 689

Stock Transfer Division
P.O. 3546 Terminal Annex
Los Angeles, Ca 90051

Bulk Rate
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